11 USC § 547(b)
11 USC 547(c)(4)
guarantor
insider
new value
preference

Creditors' Committee v. U.S. Nat'l. Bank, Adv. No. 87-0698
In re Suffola, Inc. Case No. 388-02683-S11

10/2/90 ELP unpublished

The extended preference period of § 547(b)(4)(B) applies to transfers to a non-insider creditor where the debt owed the transferee was guaranteed by an insider (approving the analysis of In re Deprizio Const. Co., 86 B.R. 545, aff'd. 874 F.2d 1186 (7th Cir. 1989)).

For the purpose of § 547(c)(4), the guarantor gave new value each time the transferee extended new credit. The record was inadequate to determine whether all essential elements of the new value defense were present.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

In Re: SUFOLLA, INC., dba Lewis Packing Company, Debtor.	)	Case No. 388-02683-S11
OFFICIAL UNSECURED CREDITORS' COMMITTEE OF SUFOLLA, INC., on behalf of the estate of Sufolla, Inc., Plaintiff,	)	Adversary No. 89-3077
v.	)	MEMORANDUM OPINION
UNITED STATES NATIONAL BANK OF OREGON, a national banking association, Defendant.	)	

The creditors' committee ("Committee) filed this proceeding to recover the value of allegedly preferential transfers. The parties filed stipulated facts and cross-motions for summary judgment.

The lending relationship between the debtor and defendant ("Bank") began in 1985 with an operating credit line secured by inventory and accounts. Insiders guaranteed repayment of the credit line. The Bank increased the operating line to $7.5 million and the debtor expanded the Bank's security interest in June, 1986 to include equipment and machinery (the "Additional Collateral"). The Bank did not file the financing statement for the Additional Collateral until August 26, 1987. The debtor filed chapter 11 on June 9, 1988.

The Committee seeks to avoid two transfers to the Bank. The first is the perfection of the security interest in the Additional Collateral. The parties agree the value of the additional collateral was $200,000 "at all applicable times" (Stipulation of Facts ¶ 11). The second transfer was a payment of $4,332.05.[1]

Up to December 1, 1987 the Bank was fully secured. After that point, the parties agree that the Bank was always undersecured. They did not agree on the amount of the deficiency at any particular date. There was a series of advances and repayments which resulted in a principal balance of almost $9 million on September 14, 1987. By the end of 1987 that figure hovered near $8 million, then decreased to $5.6 million by the

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[1] It appears that the $4,332.05 payment was from proceeds of the sale of some of the Additional Collateral. If so, the maximum recovery should be limited by the total value of the Additional Collateral, which is $200,000.

petition date.

The Bankruptcy Code bifurcates preference suits between §547[2], the avoidance of the transfer, and §550, the recovery of the avoided transfer. To avoid a transfer, the plaintiff must show all five elements found in §547(b). The stipulation provides many of the §547(b) requirements. The parties agreed that the transfers at issue were of an interest of the debtor in property:

1) to the Bank;

2) for an antecedent debt owed by the debtor before the transfer was made;

3) made while the debtor was insolvent;

4) made between ninety days and one year before the date of the filing of the petition; and

5) the transfers enabled the Bank to receive more than it would have received if the case had been filed under chapter 7 and the transfer had not been made.

The Bank defends on two fronts. First, because the Bank is not an insider, it argues that the extended preference period found in §547(b)(4)(B) is inapplicable. Second, the Bank asserts a new value defense under §547(c)(4) based on the advances made to the debtor after the transfers.

The Committee claims that the extended preference

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[2] All statutory references are to title 11 of the United States Code (11 U.S.C.) unless otherwise indicated.

period applies because the transfer to the Bank was for the benefit of the insider guarantors. In such a case, the Committee claims it can recover from the Bank as the initial transferee under §550. Finally, the Committee asserts that the guarantors did not provide any new value after the transfers, so the new value defense must fail.

The extended preference period is applicable in this case. This court has previously adopted the reasoning set forth in In re Deprizio Construction Co., 86 Bankr. 545 (N.D. Ill. 1988), aff'd 874 F.2d 1186 (7th Cir. 1989). Since this court adopted the Deprizio analysis in Morrow v. LaPrade, (In re Latitudes Marine Towing & Salvage, Inc.), Adv. No. 88-0363-S, Case No. 388-00337-S7, slip op. (Bankr. D. Or. Dec. 23, 1988)(Sullivan,J), three circuit courts have also employed the extended preference period to allow recovery of a preferential transfer from a non-insider creditor when the transfer benefitted an insider. Those decisions are: Levit v. Ingersoll Rand Financial Corp (In re Deprizio Construction Co.), 874 F.2d 1186 (7th Cir. 1989), In re Robinson Bros. Drilling Co., 892 F.2d 850 (10th Cir. 1989) and In re C-L Cartage Co., Inc., 899 F.2d 1490 (6th Cir. 1990)[3].

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[3] The bank is technically correct that the C.L. Cartage decision is factually distinguishable from Deprizio Construction and Robinson Bros. Drilling in that the lender involved in C.L. Cartage made loans directly to the insiders who relent the loan proceeds to the debtor, thus making the insiders direct rather than contingent creditors. The debtor then made some payments directly to the lender and other payments indirectly to the lender

The Bank urges the court to retreat to the position taken by many courts before 1989 and consider each transfer to be two transfers rather than one. The two transfer analysis would consider the transfer at issue as a direct transfer to the Bank and an indirect transfer to the insider. The courts using this approach have prevented recovery from the non-insider, holding that only the indirect transfer to the insider is avoidable if made outside the 90 day period. See, In re Mercon Industries, Inc., 37 Bankr. 549 (Bankr. E.D. Pa. 1984).

The Bank also offers the rationale provided by several courts which have decided that it would be inequitable to permit recovery under §550 from a non-insider for a transfer made more than 90 days before the bankruptcy filing. The circuit court opinions in Levit, Robinson Brothers, and C-L Cartage thoroughly addressed the equitable arguments and rejected them.

The Bank relies on legislative history to support its position that certain transferees are protected under §547(c), and that §550 cannot expand the scope of the trustee's avoidance powers. Section 550 permits the Committee to recover the value of the transfers from the Bank as the initial transferee to the extent that the transfers are avoidable. If there are defenses

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by issuing checks to an insider who endorsed them over to the lender. As pointed out in the court's analysis, this distinction is meaningless in determining the lender's liability for payments received directly from the debtor during the extended insider preference period because the insiders are "creditors" of the debtor under both scenarios. 899 F.2d at 1493.

available under §547(c), the transfer will be protected to the extent of the defenses, and will therefore not be recoverable from the Bank under §550.

The Bank's attempt to blur the language of the applicable Code sections by focusing on transfers and transferees should be rejected, just as such arguments were rejected in Levit, Robinson Brothers, C-L Cartage and Latitudes Marine.

The Bank's contention that the transfers at issue are not preferential because they do not fulfill all the requirements of § 547(b) as to the guarantors in this case is not well taken. Section 547(b)(4)(B) permits the trustee to avoid a transfer made to or for the benefit of a creditor referred to in §547(b)(1), between ninety days and one year before the date of the filing of the petition, if such creditor at the time of the transfer was an insider. All the elements of §547(b) which refer to "such creditor" must be fulfilled as to the insider for the extended preference period to apply.

First, the Bank argues that the insiders were insolvent. Therefore, the transfers to the Bank did not benefit the insiders even though it may have decreased their contingent liability on the guaranty. The Bank reasons that because the insiders were insolvent they were judgment proof, so a decrease in their exposure on the guaranties was of no benefit to them.

The conclusion that a person is judgment proof does not follow from their insolvency. A judgment can be satisfied from future earnings regardless of how the person's net worth appears on a balance sheet. A person is benefitted by the reduction in the amount of their insolvency. At most, if the guarantors were so hopelessly insolvent that $200,000 was not enough to make a perceptible difference on their liabilities, the degree of the guarantors' insolvency could be an issue of fact which would require further development. Generally, a decrease in liabilities is a benefit to the insider, and fulfills §547(b)(1). In re V.N. Deprizio Const. Co., 86 Bankr. 545, 553 (N.D. Ill 1988), aff'd 874 F.2d 1186 (7th Cir. 1989).

The parties agree that §547(b)(2) and (3) have been satisfied. Next, the Bank argues that the Committee has not met §547(b)(5) by proving that the transfers enabled the guarantors to receive more than they would receive if: (1) the case were a case under chapter 7; (2) the transfers had not been made; and (3) the guarantors received payment of such debt to the extent provided in a chapter 7 distribution.

The Bank's position is that only the Bank received a payment as a result of the transfers, and the guarantors received nothing. In addition, the Bank argues that the guarantors would receive nothing in a chapter 7 because their claims would be disallowed under §502(c)(1)(B) as contingent at the time of allowance, or their claims would be reduced because of the transfers to the Bank, so they would receive less under a chapter 7 because of the transfers rather than more.

These arguments also fail. First, the guarantors did receive a reduction in their debt to the Bank as a result of the payments to the Bank. Second, the legislative history of §547(b)(5) states "if the claim would have been entirely disallowed, for example, then the test of paragraph (5) will be met, because the creditor would have received nothing under the distributive provisions of the bankruptcy code." (H. Rept. No. 95-595 to accompany H.R. 8200, 95th Cong., 1st Sess. (1977) pg. 372). The analysis contemplated by §547(b)(5) compares the percentage of the creditor's claim that would have been paid under chapter 7 absent the transfer at issue with the percentage the creditor received as a result of the transfer. To the extent that the transfer transformed an unsecured claim into a secured claim, that amount of the Bank's unsecured claim was satisfied, and the same amount of the guarantors' contingent claim was also satisfied in full.

The parties agreed that the transfer allowed the Bank to receive more than it would have received in a chapter 7 and the transfer had not been made. The unsecured creditors would not have received 100% of their claims in a chapter 7, and according to the disclosure statement, probably would have received nothing. Based on principles of subrogation, the guarantors in effect received on their contingent claim whatever the Bank received as a result of the transfer. The guarantors received up to a $200,000 reduction in their contingent claim, which is more than the $0 they would have received in a chapter 7 had their claim been disallowed as contingent, or allowed as unsecured.

The Bank suggests that the payment to the Bank reduced the guarantors' contingent claim, so they would receive less in a chapter 7 because of the payment. This position misses the point. A preferential transfer is presumed to reduce the claim of the creditor benefitted by the transfer. To accurately analyze the effect of the transfer for purposes of §547(b)(5), the court should look at the amount of the claim that the guarantor would have without the transfer, and compare the percentage of that claim that was fulfilled as a result of the transfer with the percentage of the claim that the creditor would have received if the case had been a case under chapter 7, and <u>the transfer had not been made</u>. Section 547(b)(5) has been met as to the guarantors.

The final issue is whether the new value defense of § 547(c)(4) applies in this proceeding.[4] Summary judgment in favor

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[4] Subsection 547(c)(4) provides:

> (c) The trustee may not avoid under this section a transfer-
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> (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor-

of either party requires no genuine issue of material fact regarding the following elements, all of which must be present to establish the defense.

(1) The preferential transfer must be to or for the benefit of a creditor. There can be no dispute that the Bank's perfecting its security interest was for the Bank's benefit. This element has been established.

(2) After the preferential transfer, "such creditor" gave new value. The parties agree that, after the Bank perfected its interest, it advanced over $1,320,000 to the debtor. Therefore, if the Bank is the "such creditor," then this element of the defense has been shown. The Creditors' Committee argues that the guarantors, rather than the Bank, are the "such creditors" which must provide the new value.

Assuming that the guarantors are the "such creditors" which must provide the new value, I find that they have done so. Section §547(a)(2) defines new value as "money or money's worth in goods, services or new credit," except a debt substituted for an existing obligation. Courts have found an increase in a guarantor's liability sufficient to meet those requirements. See

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(A) not secured by an otherwise unavoidable security interest; and
(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor; ... .

In re Kumar Bavashi & Associates, 906 F.2d 942, 947 (3rd Cir. 1990); In re Sider Ventures & Servs. Corp., 33 B.R. 708, 712 (Bankr. S.D.N.Y. 1983); aff'd 47 B.R. 712 (D.C.N.Y. 1985). The reasoning of those cases is that a guarantor provides money's worth in the form of new credit by virtue of the increase in the guaranteed obligation. The guarantors' exposure on the guaranties increases simultaneously with each advance made to the debtor. Therefore, the guarantors were, in essence, extending new credit to the debtors each time the Bank made a new advance. The increase in liability is not an obligation substituted for an existing obligation. The requirement that "such creditor" gave new value has been met.

(3) The new value was given to or for the benefit of the debtor.

There is no dispute that the new advances were paid to the debtor. The Committee does not dispute that the debtor benefitted by the advances. This element of the defense has therefore been established.

(4) The new value was "not secured by an otherwise unavoidable security interest."

Perfection of the Bank's security interest in the Additional Collateral occurred on August 26, 1987. The parties have stipulated that on December 1, 1987, "the amount of the debtor's obligation to the Bank became greater than the value of the Collateral.[5] At no time after December 1, 1987, was the amount of Sufolla's obligation to the Bank equal or less than the value of the Collateral." The parties also agree that after that date, the Bank advanced $1,320,936.35 to the debtor.

The Bank apparently believes those facts lead to the inescapable conclusion that all advances made after December 1, 1987 were not secured by anything but the avoidable interest in equipment. Memorandum in Support of Defendant's Motion for Summary Judgment at 7. I am unable to draw such a conclusion.

The record is devoid of any reference point which establishes with certainty the extent to which the creditor was unsecured at the time of each advance. The extent to which the advances were unsecured depends upon two variables measured immediately after each advance: the amount of total outstanding debt and the value of the collateral. See §506(a). The stipulation of facts does not set forth the total amount of outstanding debt at the time of each advance. It only reflects the principal balance; accruing interest is omitted. Nor is the value of the collateral shown. That value necessarily varied, as the debtor was both selling and replenishing the collateral.[6]

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[5] The parties have agreed that, for the purpose of the Stipulation of Facts, the definition of Collateral excludes the equipment which was the subject of the preferentially perfected security interest.

[6] The Stipulation of Facts recites that the debtor purchased $107,643 worth of additional inventory which became subject to the Bank's security interest. The timing of those purchases is unknown.

Under such circumstances, there is a genuine issue of material fact regarding the extent to which the advances were unsecured.

(5) The debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor on account of the advances.

Most courts which have analyzed this language have concluded that it means the subsequent advance remains unpaid.[7] Matter of Prescott, 805 F.2d 719 (7th Cir 1986), In re Kroh Bros. Development Co., 104 Bankr. 182, 195 (Bankr. W.D. Mo. 1989), aff'd 114 Bankr. 658 (D.W.D.Mo. 1990). The Committee submits that the definition of "benefit" should be read more broadly to encompass money spent which furthers the Bank's interests. The debtor gives as examples money spent by the debtor in maintaining the business operation, preserving the collateral and processing inventory into finished goods.

Assuming the more liberal standard suggested by the Committee applied, the record is insufficient to establish how much money was spent by the debtor which benefitted the Bank. Similarly, under the traditional, more restrictive interpretation, the record is insufficient to determine whether

[7] Although this simplified translation of §547(c)(4)(B) works in most fact situations, it has been rejected when the debtor was not the party that repaid the new value, Matter of Formed Tubes, Inc., 46 Bankr. 645 (Bankr. E.D. Mich. 1985). That factual situation is not present in this proceeding; any repayments made to the Bank on account of the new value were made by the debtor.

the debtor repaid the advances. The parties agree that after the Bank became undersecured it advanced $1,320,936.35 to the debtor and the debtor paid $4,454,447.66 to the Bank. The parties further agreed that all of the post-December 1, 1987 payments were from proceeds of the Bank's collateral.

The Committee argues that, since the amount of money paid exceeded the money loaned by a factor of three, the new value was repaid several times over. The Bank contends that since the source of all payments was the collateral, all payments were applied to retire secured debt. The record is inconclusive regarding how the Bank actually applied the $4,454,447 payments, and the court cannot speculate on how it might have applied the payments.

Since the record supports conflicting inferences on whether the debtor made transfers for the benefit of the Bank on account of the advances, there is a genuine issue of material fact regarding this element.

CONCLUSION

The extended preference period for insiders applies to the Bank. There is a genuine issue of material fact regarding the new value defense of § 547(c)(4). Accordingly, the cross-motions for summary judgment should be denied.

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ELIZABETH L. PERRIS

Bankruptcy Judge